

Letter of Findings: 04-20160010
Sales and/or Use Tax
For the Years 2012, 2013, and 2014

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective as of its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Letter of Findings.

HOLDING

Medical device manufacturer's purchases of shipping labels and printer ribbons were not exempt from tax as the labels were not a material part of the processed medical devices.

ISSUE

I. Sales/Use Tax - Imposition.

Authority: IC § 6-2.5-1-2; IC § 6-2.5-2-1; IC § 6-2.5-3-1; IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-4-1; IC § 6-2.5-5-6; IC § 6-8.1-5-1; Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Scopelite v. Indiana Dep't of Local Gov't Fin., 939 N.E.2d 1138, 1145 (Ind. Tax Ct. 2010); Wendt LLP v. Indiana Dep't of State Revenue, 977 N.E.2d 480, 486 n.9 (Ind. Tax Ct. 2012); Indiana Dep't of State Rev. v. Caterpillar, Inc., 15 N.E.3d 579, 583 (Ind. 2014); Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp., 310 N.E.2d 96 (Ind. Ct. App. 1974); Indiana Dep't of State Revenue v. Kimball Int'l Inc., 520 N.E.2d 454 (Ind. Ct. App. 1988); [45 IAC 2.2-2-1](#); [45 IAC 2.2-3-4](#); [45 IAC 2.2-5-8](#); [45 IAC 2.2-5-14](#); 21 C.F.R. § 820.60; 21 C.F.R. § 820.120.

Taxpayer protests the Department's assessments on additional taxable purchases, claiming that its purchases of labels and printer ribbons were exempt from use tax.

STATEMENT OF FACTS

Taxpayer develops and manufactures minimally invasive surgical products and catheter devices for medical companies. The Indiana Department of Revenue ("Department") conducted a sales/use tax audit of Taxpayer's business records for tax years 2012, 2013, and 2014. The Department determined that Taxpayer purchased some tangible personal property to be used during the course of its business without paying sales tax or self-assessing and remitting the use tax. As a result, the Department assessed additional use tax on these purchases.

Taxpayer protested the use tax assessed on its purchases of labels and printer ribbons. An administrative hearing was held. This Letter of Findings ensues. Additional facts will be provided as necessary.

I. Sales/Use Tax - Imposition.

DISCUSSION

The Department's audit determined that Taxpayer's purchases of labels and printer ribbons were subject to use tax under [45 IAC 2.2-5-14](#). Taxpayer, to the contrary, claimed that its purchases were exempt under IC § 6-2.5-5-6.

As a threshold issue, all tax assessments are prima facie evidence that the Department's claim for the unpaid tax is valid; the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007); Indiana Dep't. of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463, 466 (Ind. 2012). Thus, the taxpayer is required to provide documentation explaining and supporting its challenge that the Department's assessment is wrong. Poorly developed and non-cogent arguments are subject to waiver. Scopelite v. Indiana Dep't of Local Gov't Fin., 939 N.E.2d 1138, 1145 (Ind. Tax Ct. 2010); see also Wendt LLP v. Indiana Dep't of State Revenue, 977 N.E.2d

480, 486 n.9 (Ind. Tax Ct. 2012). When an agency is charged with enforcing a statute, the jurisprudence defers to the agency's reasonable interpretation of that statute "over an equally reasonable interpretation by another party." *Indiana Dep't of State Rev. v. Caterpillar, Inc.*, 15 N.E.3d 579, 583 (Ind. 2014).

Indiana imposes a sales tax on retail transactions made in Indiana. IC § 6-2.5-2-1(a); [45 IAC 2.2-2-1](#). A retail transaction is a transaction made by a retail merchant that constitutes "selling at retail." IC § 6-2.5-1-2(a). Selling at retail occurs when a person "(1) acquires tangible personal property for the purpose of resale; and (2) transfers that property to another person for consideration." IC § 6-2.5-4-1(b). A person who acquires tangible personal property in a retail transaction (a "retail purchaser") is liable for the sales tax on the transaction. IC § 6-2.5-2-1(b).

Indiana also imposes a complementary excise tax called "the use tax" on "the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." IC § 6-2.5-3-2(a). "Use" means the "exercise of any right or power of ownership over tangible personal property." IC § 6-2.5-3-1(a). Tangible personal property purchased in a retail transaction is subject to use tax when the tangible personal property is "stored, used or otherwise consumed in Indiana . . . unless the Indiana state gross retail tax has been collected at the point of purchase." [45 IAC 2.2-3-4](#). When sales tax is not paid as a part of a retail transaction, use tax will be imposed unless the purchase is eligible for an exemption.

Use of tangible personal property in Indiana could be exempt from Indiana use tax if the sales tax is paid or collected at the time of the purchase pursuant to IC § 6-2.5-3-4 and [45 IAC 2.2-3-4](#). There are also various tax exemptions available outlined in IC § 6-2.5-5. A statute which provides a tax exemption, however, is strictly construed against the taxpayer. *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96, 97 (Ind. Ct. App. 1974). "[W]here such an exemption is claimed, the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." *Id.* at 101 (internal citations omitted). Thus, in applying any tax exemption, the general rule is that "tax exemptions are strictly construed in favor of taxation and against the exemption." *Indiana Dep't of State Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454, 456 (Ind. Ct. App. 1988).

Taxpayer claims that under IC § 6-2.5-5-6 its purchases of labels and the printer ribbons used to print labels were exempt from sales/use tax. IC § 6-2.5-5-6, in relevant part, states:

Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for **incorporation as a material part of other tangible personal property which the purchaser manufactures, assembles, refines, or processes for sale in his business.** (Emphasis added).

[45 IAC 2.2-5-14](#) further explains:

- (a) The state gross retail tax shall not apply to sales of any tangible personal property which is to be incorporated by the purchaser as a material or an integral part into tangible personal property produced for sale by such purchaser in the business of manufacturing, assembling, refining or processing.
- (b) The exemption provided by this regulation [\[45 IAC 2.2\]](#) applies only to tangible personal property to be incorporated as a material or an integral part into tangible personal property produced for sale by a purchaser engaged in the business of manufacturing, assembling, refining or processing. This regulation [\[45 IAC 2.2\]](#) does not apply to persons engaged in producing tangible personal property for their own use.
- (c) This regulation [\[45 IAC 2.2\]](#) does not exempt from tax tangible personal property to be used in production, such as supplies, parts, fuel, machinery, etc., refer to Regs. 6-2.5-5-5(010) and 6-2.5-5-5(020) (dealing with material consumed in direct production) for the application of those regulations to taxpayers engaged in the production of tangible personal property.
- (d) **The purchase of tangible personal property which is to be incorporated by the purchaser as a material or an integral part is exempt from tax. "Incorporated as a material or an integral part into tangible personal property for sale by such purchaser" means:**
 - (1) **That the material must be physically incorporated into and become a component of the finished product;**
 - (2) **The material must constitute a material or an integral part of the finished product; and**
 - (3) **The tangible personal property must be produced for sale by the purchaser.**
- (e) **Application of general rule.**
 - (1) **Incorporation into the finished product. The material must be physically incorporated into and become a component part of the finished product.**
 - (2) **Integral or material part. The material must constitute a material or integral part of the finished**

product.

(3) The finished product must be produced for sale by the purchaser.

(Emphasis added).

Additionally, under [45 IAC 2.2-5-8](#):

(a) In general, all purchases of tangible personal property by persons engaged in the direct production, manufacture, fabrication, assembly, or finishing of tangible personal property are taxable. The exemption produced in this regulation [\[45 IAC 2.2\]](#) extends only to manufacturing machinery, tools, and equipment directly used by the purchaser in direct production. It does not apply to material consumed in production or materials incorporated into tangible personal property produced.

(b) The state gross retail tax does not apply to sales of manufacturing machinery, tools, and equipment to be directly used by the purchaser in the direct production, manufacture, fabrication, assembly, or finishing of tangible personal property.

(c) The state gross retail tax does not apply to purchase of manufacturing machinery, tools, and equipment to be directly used by the purchaser in the production process provided that such machinery, tools, and equipment are directly used in the production process; i.e., they **have an immediate effect on the article being produced. Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property.**

(g) The fact that particular property may be considered essential to the conduct of the business of manufacturing because its use is required either by law or by practical necessity does not itself mean that the property "has an immediate effect upon the article being produced." Instead, in addition to being essential . . . the property must also be an integral part of an integrated process which produces tangible personal property.

(Emphasis added).

In this instance, Taxpayer claimed that its purchase and use of the labels and printer ribbons used to print such labels were exempt from sales/use tax under IC § 6-2.5-5-6. Taxpayer maintained that:

These labels are not only part of our manufacturing and automation processes, but are also required by our customers. Any products not labeled are rejected by our customer; therefore these labels are an integral and material part of our products, meeting the definition of IC [§] 6-2.5-5-6.

Taxpayer explained that once its products have been placed in a container for shipment, Taxpayer uses certain printer ribbons to print "direction for use" labels which are affixed to each of the containers. These labels instruct the customer on how to use the product inside. All of Taxpayer's products are irradiated and sterilized before being placed in shipping boxes. Thus, the presence of a label also serves as an indication to Taxpayer and their customers that the product inside has been properly cleaned. Taxpayer claims that it cannot sell its products to customers without the required labels, thus, it does not consider a product a finished good until the label has been applied.

In support of its claims, Taxpayer provided a copy of its Master Supply Agreement ("Agreement") between Taxpayer and one of its largest customers. The Agreement makes it clear that Taxpayer is to manufacture production in compliance with the federal Food and Drug Administration's quality system regulations. The customer may return any products to Taxpayer that don't meet these regulations.

The quality system regulations referred to in the Agreement are those found in the Code of Federal Regulations, specifically, the Food and Drug Administration's quality system regulations requirements for medical devices. The Regulations require that manufacturers of medical devices "establish and maintain procedures for identifying product during all stages of receipt, production, distribution, and installation . . ." 21 C.F.R. § 820.60. The Regulations go on to require such manufacturers to "establish and maintain procedures to control labeling activities," (21 C.F.R. § 820.120), and dictate what information labels should contain, how they should be printed and applied and how they are to be stored.

Despite the requirements mentioned above, Taxpayer's purchase and use of labels and printer ribbons did not qualify for the exemption under IC § 6-2.5-5-6 and [45 IAC 2.2-5-14](#). The audit noted that the labels were "used for shipping and inventory control." Further, "These labels were placed on the outside of the shipping containers and shipped to [T]axpayer's customers." The labels were adhered to shipment containers which were used to package

the processed tangible personal property. Thus, the labels at issue were not physically incorporated as material parts or integral parts of the tangible personal property and did not become a component part of the finished product. While Taxpayer's customers will not accept shipments without the labels and such labels are required under the law, this "does not itself mean that the property 'has an immediate effect upon the article being produced.'" [45 IAC 2.2-5-8](#). Taxpayer's use of labels and printer ribbons was post-production and is thus not entitled to the manufacturing exemption provided for in [45 IAC 2.2-5-8](#). Accordingly, the Department is not able to agree that the labels become a part of the product.

In short, Taxpayer's purchase and use of the labels and printer ribbons were not exempt under IC § 6-2.5-5-6 and [45 IAC 2.2-5-14](#).

FINDING

Taxpayer's protest is respectfully denied.

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